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Beyond Gruber: How HHS Flip-Flopped on Federal Exchange Subsidies

Obamacare Contracting Paper Trail Shows Administration's Changing Narrative

*By Scot K. Vorse**

By next June, the Supreme Court will rule on the issue of Obamacare insurance exchange subsidies in *King v. Burwell*, a case that could have significant ramifications for the Affordable Care Act (ACA). In implementing the law, the Internal Revenue Service (IRS) made individuals purchasing health insurance on both state and federally facilitated exchanges eligible for tax credits to offset part of the cost of the insurance. That rule violates the plain text of the Act, which makes such subsidies available only for insurance purchased on exchanges established by the states.

Obamacare supporters have defended the IRS rule on the grounds that the precise statutory language is a mere drafting error and that everyone involved in developing and implementing the ACA understood that subsidies were intended to be available on federal as well as state exchanges, in order to advance the ACA's overarching goal of affordability. However, a growing body of contemporaneous evidence shows that even many Obama administration officials believed just the opposite—that subsidies would only be made available on state-established exchanges.

To date, the four lower court lawsuits on this issue have primarily focused on the intent of Congress as articulated via the wording of the law. In those cases, the plaintiffs have offered substantial evidence that Congress intended the limited availability of subsidies as an inducement for states to establish their own exchanges. But there is other important evidence of the administration's intent—from both a legal and historical standpoint—that has gotten far less attention.

In the initial period after Obamacare's enactment, how did the administration itself treat the statutory language? What were the Department of Health and Human Services (HHS) and Internal Revenue Service doing to implement the law? And what do those actions indicate about their original view about whether federally facilitated exchanges qualified for tax credits? Answers to those questions support the view that

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subsidies were never intended to be provided to individuals purchasing insurance on the federal exchange.

A February 2014 congressional investigation found that the IRS initially began developing a rule to make tax credits available only on exchanges established by a state. As the findings outlined below show, HHS had a similar understanding of the law. Here, it is important to note that *in order for an exchange website to offer tax credits, it must have a tax credit calculator* that allows individuals to view the actual cost of their coverage after tax credits have been applied to their premiums. Official documents show that while HHS moved quickly after the ACA's enactment to help state governments make tax credits available through state-based exchanges, for nearly two years, it developed its HealthCare.gov website without any effort to offer tax credits on the federal exchange.

The following timeline demonstrates that HHS initially set out to establish its federal exchange, HealthCare.gov, *without* a tax credit calculator—that is, it set up the federal exchange so that it could *not* provide users any information about tax credits. This strongly suggests that its original interpretation was that *only* residents of states that established their own exchanges were entitled to tax credits. It was only after many states decided against setting up exchanges that HHS and the Obama administration changed course and began claiming that the Affordable Care Act allows tax credits for both state and federally facilitated exchanges. Only then did HHS begin developing a tax credit calculator for HealthCare.gov.

Stage One: March 23, 2010 – February 28, 2011, "Hurry up and get the 50 state exchanges setup"

President Obama signed the Affordable Care Act into law on March 23, 2010.The first year following enactment of the ACA was a critical time for planning Obamacare's implementation. The Department of Health and Human Services made significant efforts to help states develop tax credit calculators for their exchanges and to help states collaborate with one other in this endeavor. But at the time, HHS appeared to make no effort to build a HealthCare.gov tax credit calculator or collaborate with states to develop this technology.

> **September 30, 2010 – Under the ACA, HHS grants millions to state exchanges but nothing for the federal exchange.** Six months after enactment of the Affordable Care Act, HHS starts awarding grants to states, as authorized under the ACA, to establish state-based insurance exchanges. HHS awards over $4.8 billion to states and the District of Columbia to plan and establish exchanges, according to an October 29, 2014 Congressional Research Service report.[1]As Amy Goldstein and Juliet Eilperin wrote in *The Washington Post*on November 2, 2013, "Although the statute provided plenty of money to help states build their own insurance exchanges, it included no money for the development of a federal exchange."[2]

- **November 3, 2010 – HHS starts to distribute state exchange guidance documents requiring a tax credit calculator.** HHS publishes a *Guidance for Exchange and Medicaid Information Technology (IT) Systems*.[3]Its purpose was to "assist states as they design, develop, implement, and operate technology and systems projects in support of the Affordable Care Act relating to the establishment and operation of Health Insurance Exchanges." Over the next 12 months, HHS distributes at least 18 different guidance and advisory documents related to state exchanges. These documents require all state exchanges to have tax credit calculators and to collaborate with health policy officials in other states. Despite numerous complaints by states, no guidelines for HealthCare.gov were distributed by HHS until May 16, 2012—more than 18 months later.

- **January 20, 2011 –Another policy document specifies state-operated exchanges 17 times.** Nearly three months after issuing its first guidance document, HHS releases the *Cooperative Agreement to Support Establishment of State-Operated Health Insurance Exchanges*, the governing agreement for establishing "state-operated" health insurance exchanges. That document provides significant insight into HHS' views at the time.[4] This agreement specifies "state-based" or "state-operated" exchanges 17 times. The terms "federally facilitated exchange" and "federal exchange" are never used.[5]

- **February 16, 2011 – HHS awards millions to states to develop key technology and collaborate with other states but keeps HealthCare.gov out of the picture.**As several states begin developing their insurance exchanges, HHS announces$241 million in grants to "Early Innovators" for six states and a multi-state consortium.[6]The press release states: "Using these new funds, the Early Innovator states will develop Exchange IT models that can be adopted and tailored by other states." Although HHS is deeply involved in the process of developing this technology for state exchanges, there is no mention of any involvement, collaboration or sharing of technology with a Federal exchange or HealthCare.gov.[7]

- **Prior to Early March 2011 – Early drafts of tax credit regulations specify tax credits are only for state established exchanges.**After a months-long investigation into the development of the IRS's tax credit rule, a Joint Staff Report to the U.S. House of Representatives published on February 5, 2014, concludes: "Early drafts of the proposed premium subsidy regulation contained the statutory language restricting tax credits to Exchanges 'established by the State.'"[8] This language was removed from those drafts in early March 2011, but its initial inclusion strongly suggests the IRS believed for at least a full year that the law prohibited subsidies for purchasers on the federal exchange.

Stage Two: March 1, 2011 – December 31, 2011, "We may have a problem"

Even after the IRS's view of the law began to shift, HHS continued to make efforts to get states to develop tax credit calculators and to collaborate with each other. It was not until several months later that HHS similarly shifted into discussing potential collaboration with the states.

- **March 16, 2011 – HHS creates an online system for states to share technology with other states but not with HealthCare.gov.** HHS releases a document entitled *Collaborative Environment and Life Cycle Governance – Exchange Reference Architecture Supplement*, which outlines guidelines and procedures for an online system for states to share technology, including a tax credit calculator.[9] HHS uses sample states (i.e. "State 1" or "State 2") to illustrate how states can share technology on the online system. The document makes no mention of HealthCare.gov or a federal exchange.

- **March 23, 2011 – Louisiana announces that it will not set up a health insurance exchange.**[10]

- **July 15, 2011 – HHS issues a request for comments that suggests it has not started developing a tax credit calculator.** HHS releases draft rules for health insurance exchanges and qualified health plans, and requests comments on whether a model tax credit calculator would be helpful for the states. This request suggests HHS has not yet started developing a tax credit calculator.[11]

- **July 16, 2011 –A senior HHS official confirms at least "a small handful" of states will not establish an exchange.** Steven Larsen, Director of the Office of Consumer Information and Insurance Oversight at HHS, is asked at the Annual National Governors meeting in July 2011 how many states he believes would not establish an exchange. Larsen responds: "[A]t the end of the day, sure there may be, I hope a small handful of states that will ask us to do everything."[12]

At this point, HHS knew it would need to build an exchange for at least one state. Furthermore, if HHS believed at the time that the intent of the law was to provide tax credits for individuals who purchased insurance on federally facilitated exchanges, then HealthCare.gov would need a tax credit calculator. However, as the timeline illustrates, HHS did not contract to build a tax credit calculator for HealthCare.gov until May 3, 2012—nearly 10 months later. The most plausible reason for the delay was that HHS believed that the ACA did not authorize tax credits for individuals using federally established exchanges.

- **September 30, 2011 – HHS signs a contract with HealthCare.gov developer without requiring a tax credit calculator.** HHS signs a contract with CGI Federal to develop HealthCare.gov with a revised Statement of Work.[13] The contract does not mention a tax credit calculator and includes only five references to tax credits. All of these references are unrelated to HealthCare.gov providing tax credits.[14]

- **November 29, 2011 – Now that HHS knows some states will not establish their own exchanges, references to "state-based" exchanges are eliminated from a key document.** As the status of state exchanges becomes imperiled, the exchange guidance language also shifts. HHS produces a revised version of the above Cooperated Agreement document, which was originally dated January 20, 2011. There is still no mention of HealthCare.gov. However, six phrases in the document regarding "state-based" or "state-operated" exchanges are eliminated.[15]

Stage Three, January 1, 2012 – May 16, 2012, "We definitely have a problem"

HHS and the Obama administration face a dilemma. States complain that they need a final ruling as to whether tax credits are to be made available on federally facilitated exchanges. Unfortunately for Obamacare, both options are problematic. If HHS changes its previous interpretation of the law and decides they are allowed, that eliminates the primary incentive for states to establish their own exchanges. But if HHS sticks with its original interpretation that only state-based exchanges can receive tax credits and this incentive still fails to convince most states to establish these exchanges, then Obamacare's stated goal of affordability would be fatally undermined. A stand-off has developed at this point. The deadline for a decision is quickly approaching, but states do not want to decide until they know HHS' decision, and HHS does not want to decide until it knows the states' decisions.

- **January 11, 2012 – Seven states request written opinion from Attorney General on federal exchange tax credits so they can make a decision:** Seven states—Kentucky, Maine, New Mexico, North Dakota, Tennessee, Utah, and Virginia—send a request to HHS for information on HealthCare.gov "in order for us to make an informed decision about the direction we should pursue" regarding establishing exchanges.[16] One piece of information requested is "[a] written legal opinion from the Office of the Attorney General or a declaration from a federal court ... detailing the authority of the federal government in all operational aspects of the exchange, including, but not limited to the authority to administer premium tax credits." For at least these seven states, tax credits for a federal exchange is a material issue.

- **March 1, 2012 – HHS Secretary Sebelius still not ready to announce key decision:** Republican members of the House Energy and Commerce Committee complain about the lack of guidance for states on deciding whether or not to set up exchanges. HHS Secretary Kathleen Sebelius promises regulations on exchanges will be out in a "couple of months."[17]

- **March 27, 2012 – IRS publishes Final/Interim final rules.** The IRS distributes Final rules/Interim final rules. One noteworthy comment in the filing is that the IRS took "recommendations into account" for HealthCare.gov as a model tax calculator. By this time, HHS has been granting money and requiring states to develop tax credit calculators for 18 months, yet still the federal government is only considering building a model tax calculator.[18]

- **Prior to May 1, 2012 – Mark Mazur, Assistant Treasury Secretary for Tax Policy, testifies that he never saw any analysis to authorize tax credits for the HealthCare.gov states prior to May 1, 2012**. By now, the IRS has effectively finalized the guidelines authorizing tax credits for HealthCare.gov states.[19]

- **May 3, 2012 - HealthCare.gov modifies contract statement of work and now requires a tax credit calculator and collaboration with states.** HHS revises the CGI contract Statement of Work. The revised statement of work has three significant modifications:

    - 1) A tax credit calculator is now required on HealthCare.gov (there are seven references to a tax credit calculator in the modified statement of work compared to none in the original);
    - 2) HHS will from this point forward collaborate with states; and
    - 3) CGI is now required to go on 10 to 12state visits to share technology.

  In short, more than two years after the law passed, HHS has finally decided it must start developing a tax credit calculator for HealthCare.gov.

- **May 16, 2012 – HHS finally distributes HealthCare.gov guidance.** The guidance says that states operated as part of HealthCare.gov are entitled to premium tax credits.[20]

HHS completely shifts its position to one that HealthCare.gov "must" develop a tax credit calculator and collaborate with states. Although HHS is now developing a tax credit calculator for HealthCare.gov, the funding commitment for states to build their own tax credit calculators appears not to have decreased. The revised IRS regulations related to tax credits have now also completely shifted to allow tax credits for federal exchange states.

Stage Four, May 17, 2012 – present: "We never had a problem. We always knew that the law intended for states that didn't set-up an exchange to receive tax credits."

Washington and Nevada distribute documents that suggest HealthCare.gov had been developed with a tax credit calculator and therefore was always intended to provide tax credits. Older documents suggest otherwise, but final IRS guidelines are consistent with HHS's new narrative.

- **Prior to May 23, 2012 – The State of Washington requests more money from HHS to build a tax credit calculator. In the same document it also claims it "intends to use" a HHS-developed tax credit calculator**. The statement implies HHS has already developed a tax credit calculator. Why is a state asking for money if it "intends to use[21]" a HHS-developed tax credit calculator?[22]

- **June 28, 2012 – Nevada also asks for money to build its own tax credit calculator, even though it also "intends to use" the HHS-developed tax credit calculator. Interestingly, both Nevada's and Washington's grant requests use the exact same language and punctuation.** Why does this contradictory identical language and punctuation suddenly appear in two state grant requests? The most likely answer is that HHS provided the language to both states.[23] The language is consistent with the Obama administration's shift in interpretation, and builds the case that HHS has always been developing a tax credit calculator. Furthermore, HHS was loath to rescind the grants because it would have demonstrated that its interpretation of the ACA had changed over time.

Conclusion. As the above timeline clearly demonstrates, the Obama administration and the Department of Health and Human Services required states establishing their own exchange to build a tax credit calculator. However, for two years after passage of the law, they did not require the same for the federal exchange. These actions provide additional support that the Obama administration and HHS understood that only states that established their own exchanges were entitled to tax credits—the exact opposite of what they have been arguing in federal court.

Notes

[1] Annie L. Mach, C. Stephen Redhead, "Federal Funding for Health Insurance Exchanges," *Congressional Research Service,* 7-5700. R43066. (2014), pp. 1-8.
[2] Amy Goldstein, Juliet Elperin, "Healthcare.gov: How political fear was pitted against technical needs," *The Washington Post*, November 2, 2013, http://www.washingtonpost.com/politics/challenges-have-dogged-obamas-health-plan-since-2010/2013/11/02/453fba42-426b-11e3-a624-41d661b0bb78_story.html. Also see Scot Vorse, "Whoops! HHS Screws up Obamacare Collaboration," *gotnews.com*, September 15, 2014, http://gotnews.com/whoops-hhs-screws-obamacare-collaboration/.
[3] Department of Health and Human Services, "Guidance for Exchange and Medicaid Information Technology (IT) Systems," *Office of Consumer Information and Insurance Oversight*, Version 1.0, (2010) 1-8, https://www.cms.gov/apps/docs/Joint-IT-Guidance-11-3-10-FINAL.pdf.
[4]HHS, "Cooperative Agreement to Support Establishment of State-Operated Health Insurance Exchanges," *Office of Consumer Information and Insurance Oversight*, CFDA: 93.525, (2011), pp. 1-89, https://www.cms.gov/CCIIO/Resources/Funding-Opportunities/Downloads/foa_exchange_establishment.pdf.
[5] Vorse, "HHS Obamacare Agreement Also Full of 'Typos,'" Breitbart, August 15, 2014, http://www.breitbart.com/Big-Government/2014/08/14/HHS-Obamacare-Agreement-also-full-of-typos.
[6] The Center for Consumer Information and Insurance Oversight, "States Leading the Way on Implementation: HHS Awards "Early Innovator" Grants to Seven States," *CMS.gov*, http://www.cms.gov/CCIIO/Resources/Grants/states-leading-the-way.html.
[7]Vorse, "Feds Predicted Federal Exchange Website Would Cost Less Than That of a Single State…." gotnews.com, September 22, 2014, http://gotnews.com/feds-predicted-federal-exchange-website-cost-less-single-state/.
[8]Reps. Darrell Issa and Dave Camp, "Administration Conducted Inadequate Review of Key Issues Prior to Expanding Health Law's Taxes and Subsidies," *U.S. House of Representatives*, (2014), pp. 1-35, http://oversight.house.gov/wp-content/uploads/2014/02/IRS-Rule-OGR-WM-Staff-Report-Final1.pdf.
[9]HHS, Centers for Medicare and Medicaid Services, "Collaborative Environment and Life Cycle Governance – Exchange Reference Architecture Supplement," Version 0.91, (2011), pp. 1-30, http://www.dirigohealth.maine.gov/Documents/Collab%20Env%20LifeCycle%20Governance%20ERA%20Supp%20Drft%20v093%2003162011.pdf.
[10] Jan Moller, "Louisiana to opt out of health insurance exchanges in federal law," *New Orleans Times-Picayne,* March 23, 2011, http://www.nola.com/politics/index.ssf/2011/03/louisiana_to_opt_out_of_health.html.
[11] HHS, *Federal Register*, Vol. 76, No. 136, (2011), 41866-41927.
Here is the relevant language, at 76 Fed. Reg. 41876: "In paragraph (c), we propose to codify section 1311(d)(4)(G) of the Affordable Care Act that requires an Exchange to establish an electronic calculator to assist individuals in comparing the costs of coverage in available QHPs after the application of any advance payments of the premium tax credit and cost-sharing reductions. *We invite comment on the extent to which States would benefit from a model calculator and suggestions on its design.*" [Emphasis added]
[12] National Governors Association, "2011 Annual Meeting Audio and Video Files," July 17, 2011, http://www.nga.org/cms/home/news-room/audio--video/page_2011/col2-content/main-content-list/2011-annual-meeting-audio-and-vi.html. *See* Saturday July 16 – Session 2, Q + A, minute 33,http://media.nga.org/AM2011/AM11SatHHS05QA.wmv.
[13]HHS, "Federal Exchange Program System Federal Exchange Statement of Work," *The Black Vault*, September 30, 2011, http://documents.theblackvault.com/documents/health/r_CombinedCGIDocs.pdf. Compare the 2011 contract to the January 2013 version of the contract, in which the Introduction states at 4–5 that "the Exchange consists of the following business functions," including "[c]onsumer tools and information to support calculation of out of pocket costs, available subsidies, and information to make appropriate choices of affordable coverage." It also states that "key Exchange IT systems modules

shall include, but not be limited to … [p]remium tax credits administration" and "[c]ost-sharing assistance administration." Moreover, section 2.3.4.2.1 of the January 2013 contract, entitled "Exchange Website and Premium Tax Credit and Cost-sharing Reduction Calculator," states: "Each Exchange will maintain a website through which enrollees and prospective enrollees may: obtain standardized comparative information on qualified health plans, apply for coverage, and enroll online. Exchange websites will also need to post required transparency information. Exchanges may choose to provide many more services on their websites. In addition, each Exchange website will need to provide access to an electronic calculator that allows individuals to view a preliminary actual cost of their coverage once premium tax credits have been applied to their premiums, as well as the impact of cost-sharing reductions, if they are eligible."

[14]See Vorse, "RESEARCH: Original Obamacare Website Contract Had No Federal Tax Credit Consumer Functionality Language," gotnews.com, August 26, 2014, http://gotnews.com/research-original-obamacare-website-contract-federal-tax-credit-consumer-functionality-language/; and Vorse, "#Obamacare's Tax Troubles Just Got Worse," gotnews.com, September 8, 2014, http://gotnews.com/tax-mess-obamacare/.

[15]HHS, Centers for Medicare & Medicaid Services, Center for Consumer Information and Insurance Oversight, "Cooperative Agreement to Support Establishment of State-Operated Health Insurance Exchanges," IE-HBE-11-004 CFDA: 93.525, (2011), pp. 1-97, http://apply07.grants.gov/apply/opportunities/instructions/oppIE-HBE-11-004-cfda93.525-cidIE-HBE-11-004-012241-instructions.pdf.

[16]HHS, "State Consultation on the Development of a Federal Exchange," available at http://www.docstoc.com/docs/172915892/insidehealthpolicycom_sites_insidehealthpolicycom_files_documents_jan2012_he01202012_states.

[17] Choice & Competition Coalition, "Sebelius Promises Exchange Rules In 'A Couple Months' As GOP Deplores Lack of Guidance," *Choiceandcompetitioncoalition.org*, March 1, 2012, http://www.choiceandcompetitioncoalition.org/headlines/sebelius-promises-exchange-rules-in-a-couple-months-as-gop-deplores-la.

[18]HHS, *Federal Register*, Vol. 77, No. 59 (2012), 18327.

[19]Issa and Camp, "Administration Conducted Inadequate Review of Key Issues Prior to Expanding Health Law's Taxes and Subsidies," *U.S. House of Representatives*, February 5, 2014, http://oversight.house.gov/wp-content/uploads/2014/02/IRS-Rule-OGR-WM-Staff-Report-Final1.pdf.

[20] Center for Consumer Information and Insurance Oversight, Centers for Medicare & Medicaid Services, "General Guidance on Federally-facilitated Exchanges," (2012), pp. 1-19, https://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/Downloads/ffe-guidance-05-16-2012.pdf.

[21] Center for Consumer Information and Insurance Oversight, "Cooperative Agreement to Support Establishment of State-Operated Health Insurance Exchanges," FOA: IE-HBE-11-004, (2014), pp. 1-63, http://wahbexchange.org/wp-content/uploads/HBE_L2Grant_Application.pdf. The language is as follows: "The Exchange intends to use the model Premium Tax Credit/Cost Sharing Calculator developed by HHS to assist individuals in comparing the costs of coverage in available QHP."

[22]See Vorse, "Why Did States Spend Millions to Create Tech That Healthcare.gov Had Already Developed?" gotnews.com, October 2, 2014, http://gotnews.com/states-spend-millions-create-tech-healthcare-gov-already-developed/.

[23] Center for Consumer Information and Insurance Oversight, "Cooperative Agreement to Support Establishment of State-Operated Health Insurance Exchanges," *exchange.nv.gov*, FOA: IE-HBE-11-004 (2012) 1-39. Nevada funding request available at http://exchange.nv.gov/uploadedFiles/exchangenvgov/Content/Reports/Level%20II%20Grant%20Application.pdf. The language is indeed very similar: "The Exchange intends to use the model Premium Tax Credit/Cost Sharing Calculator developed by HHS to assist individuals in comparing the costs of coverage in available QHPs. The Eligibility Engine will calculate the dollar amount of Advances Premium Tax Credit and cost sharing reduction."